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# TRADE AND ECONOMIC POLICY COMMENTARY No. 21



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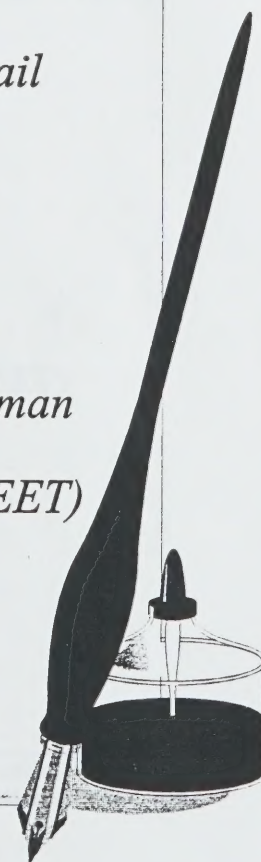
*An Integrative View*

*By:*


*Prakash Sharma and Gail Tyerman*

*Trade and Economic Analysis (EET)*

(October 1998)



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*Department of Foreign Affairs  
And International Trade*

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**Does Trade Promotion Dovetail with Trade Policy?**

**An Integrative View**

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## Executive Summary

*..... Trade policy is like a new advanced-technology device, while trade promotion allows you to install and explore the device and profit from its use.*

The purpose of this commentary is to examine the relationship between trade policy and trade promotion in the emerging world trading system. The success of the new technology of trade policy in crafting predictable and transparent international rules as well as promoting enhanced market access only becomes real when heretofore domestically focussed producers and workers make the transition to a more international outlook.

Trade promotion helps the reallocation of resources that trade engenders, including job-creation, and higher productivity and specialization that facilitate the shaping of new comparative advantages and a more internationally active focus. Further, expanding exports helps to pay for imports, thereby strengthening the domestic economy over time. In Canada, as in other countries, import growth has largely paralleled export growth, reflecting the advantages of an increasingly open rules-based international trading system.

Successful penetration of foreign markets creates traders who can provide useful feedback on current trade policies as well as provide advice about, and support for, further liberalization of international trade and investment.



## Does Trade Promotion Dovetail with Trade Policy?

### An Integrative View

Multilateral, regional and bilateral trade agreements in the post-war period have made foreign markets and cross-border investment more accessible and the rules of international commerce more predictable than ever before. Many of the rules of the World Trade Organization (WTO) and regional trade agreements have reduced the role of governments in influencing trade flows by reducing tariffs and by restricting most direct and some indirect export and industrial subsidies. At the same time, many governments have increased their support for foreign trade promotion. High profile trade missions have come into vogue, especially from North America, Europe and Australia. In the Canadian context, "Team Canada" missions in the past three years have attracted widespread public recognition of the government's active role in International Business Development.<sup>1</sup>

Traditionally, commentators espousing a liberal trading system have castigated or minimized the importance of export promotion, powered by taxpayers' money, as a mercantilist relic. They see efforts dictated or encouraged by governments to increase exports as based upon a false premise that exports are proof of a country's competitiveness and economic well-being, rather than as the more realistic but prosaic reason that exports are only a means to pay for imports.<sup>2</sup> They also fear that government attention to export promotion has potential diplomatic and economic costs, and suggest, therefore, that government efforts would be better spent on negotiating even better international rules of the game and more open markets.

The purpose of this commentary is to assess these arguments and to explore how and why trade promotion policies continue to have a useful role in the world trading system.

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<sup>1</sup> The term "International Business Development" encompasses not only goods and services export facilitation but also a broader range of activities that governments undertake, such as inward investment promotion, facilitation of joint ventures with foreign partners, promotion of technology licensing agreements, and strategic market information. In this paper, the term trade promotion will be used in its broader sense to include all trade facilitation measures that governments undertake.

<sup>2</sup> See *The Economist*, "Governments and Exports: Thoroughly Modern Mercantilists", February 1<sup>st</sup>, 1997, pp. 23-5, for a view that governments should not be in the business of export promotion.



## 1. The idea of export promotion

In its earliest manifestation, export promotion was characterized by **Mercantilism**, a sixteenth-century economic philosophy, which maintained that a country's wealth was to be measured by its holdings of gold and silver. To enlarge such holdings, this doctrine held that an economy should maximise the difference between its exports and its imports by promoting exports and discouraging imports. To do so, exporters favoured export subsidies or tax rebates, while domestic competitors of imports favoured high tariffs and other protectionist policies. In adopting such policies through much of the early modern era and beyond to our own time, governments gave consumer interests short shrift.

### 1.1 The symmetry of export and import growth

The development of economic theory in the late eighteenth century and throughout the nineteenth century improved our understanding that, contrary to mercantilist thought, the real purpose of exports is to pay for imports and thereby improve the efficiency and growth prospects of the economy. When a country increases its imports, consumer and corporate welfare increase. At the same time, a country's workers and firms will have to produce and export additional goods and services to pay for the imports. It is notable that countries exporting a large proportion of their GDP also import a significant share of their GDP.

Table 1 illustrates that regardless of the size of its economy or percentage of its GDP devoted to trade, exports and imports are of a similar magnitude. Countries such as Japan, the U.S. and Mexico have a smaller share of exports of goods and services of their GDP also have a smaller share of imports of their GDP. Countries such as Canada, the Netherlands and Belgium have a larger share of imports and exports in proportion to their GDP. Thus, exports and imports can be seen as two sides of the same coin.



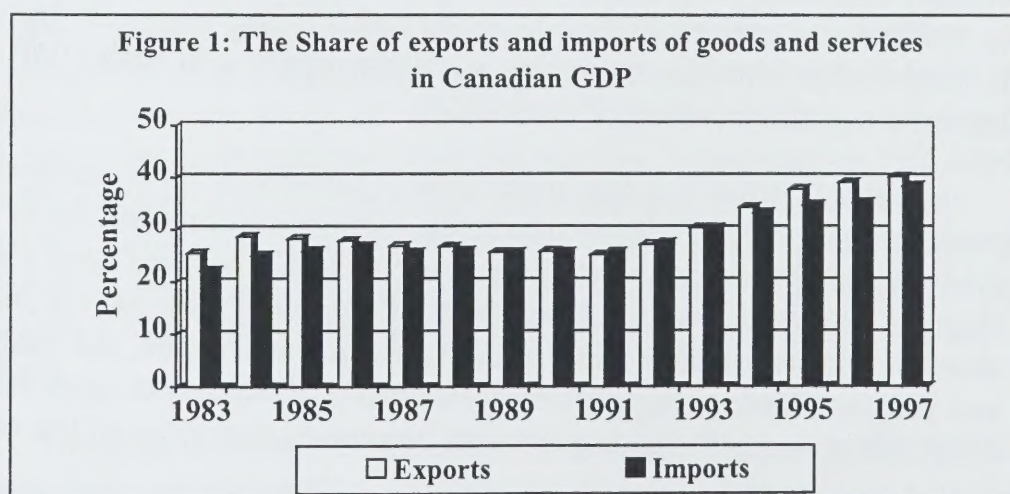
**Table 1:** The share of exports of goods and services in national GDP, 1996, selected economies

	Export share in GDP	Import share in GDP
Japan	10.2%	9.7%
United States	11.3%	12.8%
Mexico	14.0%	12.7%
France	23.6%	21.5%
Germany	25.9%	24.7%
Canada	38.8%	35.6%
Netherlands	56.7%	51.0%
Belgium	71.1%	66.8%

Sources: Calculated from the IMF's *Direction of Trade, 1997*, and the OECD's *Economic Outlook, 1998*.

## 2. Canada's export and import performance in an increasingly open trading system

Figure 1 shows that export growth in Canada between 1983 and 1997 has been accompanied by import growth.



The share of exports of the Canadian GDP increased by 14.7 percentage points to 40.2% in 1997 from 25.5% in 1983. At the same time, the share of imports of the Canadian GDP also increased by 16.3 percentage points to 38.5% in 1997 from 22.2% in 1983. Economic (GDP) growth in Canada and the favourable relative prices of imports largely powered Canadian import growth. Had Canadian exports not risen, Canada would have had a balance of payments deficit, which may have required further



depreciation of the Canadian dollar or other measures to boost exports, resulting in a lower overall standard of living.

### **3. Trade promotion facilitates adjustment**

Trade policy plays a key role in increasing trade flows. It focuses on improving access to foreign markets through agreements on the reduction of tariff and non-tariff barriers and improvements to the predictability and transparency of the trading system.<sup>3</sup> This provides the private sector with a more stable environment in which to exploit economic opportunities across borders. Nevertheless, such an enhanced environment may not be enough in itself to facilitate change in the actions those economic units, either public or private, which actually do the trading. It is at this point that trade promotion can play an important role in promoting the dissemination of the opportunities provided by the results of an active trade policy.<sup>4</sup>

Arguably, exporting is especially risky because traders and producers have less information about foreign than about domestic markets. In principle, each firm can assess risks in exporting and take measures to reduce and diversify such risk. In practice, there are costs associated with risk reduction, which would reduce the incentive to seize marketing opportunities abroad.<sup>5</sup> In such a case, the resource allocation, and hence job-creation, in Canada or in any potential exporting country would be sub-optimal.

Larger established corporations are more likely than smaller firms to have the resources to obtain and process information concerning foreign markets. These firms probably had some input, formal or informal, in shaping the Canadian negotiating position for the development of international trade rules in its sector or area of interest. However, the aim of trade policy cannot be to liberalize trading opportunities only for established corporations. New entrants to export markets also should be encouraged to benefit from trade agreements. A broader-based Canadian business

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<sup>3</sup> Trade Policy tools include: the negotiation of multilateral, regional, and bilateral trade agreements to liberalize tariff and non-tariff barriers; dispute settlement assistance using informal and formal mechanisms; market access support; enhanced co-operation between regulatory regimes in areas such as tax, competition policy, environment, and labour policies; and, increasingly, mutual recognition of standards.

<sup>4</sup> In Canada, trade promotion includes: market prospect advice; key contact search; raising awareness of Canada and its capacities in the local market; visit information; briefing; and troubleshooting to help resolve urgent market access issues.

<sup>5</sup> On the risk-avoidance argument, see W. Max Corden, *Trade Policy and Economic Welfare*, 2<sup>nd</sup> edition, Oxford: Oxford University Press, 1997, pp. 185-8.



community enjoying market access would spread trade benefits deeper in society and throughout the economy. To achieve this, existing and new enterprises would have to graduate from a business culture that was largely domestically focussed to one with an international outlook.

### 3.1 Should governments facilitate the transition from domestic to international markets?

- - In trade theory, there are theoretical arguments for export promotion (in fact, export subsidies) in cases such as:<sup>6</sup>

- When the export markets require investment to promote a product to foreign buyers who are not aware of a country's capacity to export this type of good or service,
- When the returns to investment in export promotion could accrue to other potential exporters,
- When export promotion is used to offset the anti-trade bias or other protectionist policies in the importing country, and
- When export promotion lends credibility to the government's commitment to the maintenance of a trade-liberalization policy framework.

Commenting on the merits of trade liberalization and the outward-looking strategy of export promotion adopted by certain east-Asian economies, Bhagwati observes that:

"The empirical studies of these successful regimes show that they typically involved an explicit endorsement of export promotion by the governments, with subsidies and credit mechanisms geared to that end."<sup>7</sup>

However, direct export subsidies cannot be recommended. First, picking winning companies is not only a speculative gamble but also a strategy where governments have a dismal record. Secondly, an export subsidy to a potential world champion will lower national economic welfare.<sup>8</sup> Thirdly, a policy of outright subsidies to specific firms or sectors to compete for export markets would run counter to WTO disciplines, which now cover specific export subsidies.

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<sup>6</sup> Jagdish N. Bhagwati, *Protectionism*, Cambridge, MA: MIT Press, 1988, pp. 95-6.

<sup>7</sup> Bhagwati, 1988, *ibid*.

<sup>8</sup> See Paul Krugman and Alasdair Smith (eds.), *Empirical Studies of Strategic Trade Policy*, Chicago: University of Chicago Press, 1994; and P. Sharma and K. Christie, "And the Devil Takes the Hindmost: The Emergence of Strategic Trade Policy", Policy Staff Paper, No. 93/14, Foreign Affairs and International Trade, Ottawa, 1993.



On balance, where firms do not have the capacity to obtain the necessary market information that could trigger their entry into foreign markets, the government may play a legitimate role in providing market information and other intelligence as well as services to facilitate potential exporters' transition to international markets. In assisting the transition to a freer trade environment, export promotion can speed up the structural adjustment and the investment of resources and entrepreneurial energies in the exploitation of foreign markets.

It should be noted that many countries established trade promotion organizations long ago to support their exporters and an increasing number of emerging countries are following suit.<sup>9</sup> Although the structure and delivery mechanisms of trade promotion organizations may vary, their objectives are to help domestic firms penetrate new markets and internationalize their operations. Over the years these organizations have evolved in order to continue to provide a competitive edge to their clients and offer more value-added services. The value of such trade promotion activities is attested to by several industrialized countries where business clients are now willing to pay for such services.

Trade missions too have evolved. Although they are still a key promotion vehicle, they have grown in size. For example, a growing number of our competitors, such as the U.S., France, Germany, Australia and Brazil, are orchestrating mega-missions in an effort to enhance their visibility and their market share at the expense of others, including Canadian firms. Taking on such sophisticated initiatives is undoubtedly costly. However, private sector clients in Canada and elsewhere are increasingly sharing the costs of these and other services, and thus ensuring their commitment and a more efficient use of public resources.

### **3.2 Intra-industry trade: Export promotion requires a liberalized import regime**

One consequence of internationalization of production and other economic activity is that competitively-priced and state-of-the-art parts for final export items may have to be partially sourced from suppliers abroad. Intra-industry and intra-company trade (i.e., trade in components,

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<sup>9</sup> Indeed, the latest version of "Profiles of Trade Promotion Organizations" published by UNCTAD/WTO covers 123 trade promotion organizations from 115 countries.



intermediate inputs and product varieties)<sup>10</sup> has contributed to the growth of imports into Canada. If import-distorting trade measures make imported inputs more expensive in Canada than abroad, domestic exporters would not be competitive in international markets. Because imports can be an important support for jobs in export-oriented industries, export promotion can only be successful when there is an effective system of trade rules for both imports and exports.

### **3.3 Export promotion and foreign investment**

To be competitive in the global marketplace, domestically based firms require access to cost-effective technology, new knowledge and ideas.<sup>11</sup> Foreign direct investment in Canada, joint-ventures in Canada and abroad, and Canadian foreign investment abroad are important sources for such new technology and business know-how.

As the nature of the global economy evolves, we are likely to see more, not less, need for companies to obtain and retain a global niche based upon world class technologies, best business practices and productivity. The share of primary products in total Canadian exports has steadily declined to 20% in 1997 from 43% in 1963.<sup>12</sup> Evidence also suggests that since 1989 knowledge-intensive sectors have powered Canadian export growth to the United States.

## **4. Advertising trade promotion and trade policy**

As one important instrument of trade promotion, the Team Canada missions advertise Canada as an exporting country and a place to locate investment. Studies show that advertising has the most impact on people about to make a decision. A firm heretofore primarily domestically focussed and in need of restructuring its business and products is a good candidate to receive to the Team Canada message. It sees that it is possible to explore international markets because others are seen doing it on the trade mission.

Such repeated advertising is one way to assist the private sector in planning new business opportunities. Government trade promotion

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<sup>10</sup> For inter-country evidence on the link between import penetration and intra-industry trade, see Sylvia Ostry and Richard Nelson, "*Techno-nationalism and Techno-globalism: Conflict and Cooperation*", Washington, Brookings Institution, 1995, pp. 14-21.

<sup>11</sup> For the idea that technology-based competition for international markets could result in "systems' frictions", see Sylvia Ostry and Richard Nelson, *op. cit.*, 1995; and Lester C. Throw, *Head to Head*, 1992.

<sup>12</sup> Statistics Canada Catalogues 65-001 and 65-003.



programmes are there to facilitate the transition of a potential exporter, sitting on the domestic fence, to an international market player. Government support for trade promotion encourages new entrants into the international marketplace, who in turn provide support for further trade and investment liberalization.

## **5. Trade promotion and new trade policy initiatives**

Firms active in the export market are often the best source of real world knowledge about non-tariff barriers and other market access problems. Such firms as well as official trade promotion agencies can report back to trade policy specialists in governments on emerging market access problems as well as non-compliance by foreign governments to agreed disciplines and commitments. This in turn can be an important input to the development of trade policy priorities. For example, the experience of Canadian companies abroad has been an important ingredient in the formulation of Canadian policy concerning the accession of new countries into the WTO, particularly in the case of China and Saudi Arabia.<sup>13</sup>

The feedback from trade development officers can also be incorporated in the WTO surveillance mechanism, the Trade Policy Review Mechanism (TPRM). The Trade Policy Review Body at the WTO can further collate the experience of individual countries on the impact of trade-related policies.<sup>14</sup> This information, together with other sources, can be used to further shape the contours of new trade round.

## **6. Conclusion**

In the current environment, it would not be appropriate to construe a zero-sum play between trade policy and trade promotion. This commentary has presented evidence that exports should be viewed in the broadest context as an income flow to pay for imports. Export promotion enlarges the import-buying capacity of an economy. Successful export promotion requires a liberalized import, inward-investment and outward-investment regime. In a freer trade and investment environment, trade promotion by governments

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<sup>13</sup> Officers from the Canadian Department of Foreign Affairs and International Trade have reported to the authors the utility of advice received from Canadian companies doing business in these countries and the importance of improving this feed-back link.

<sup>14</sup> On TPRM, see Sylvia Ostry, *The Post-Cold War Trading System*, Chicago: University of Chicago Press, 1997, p. 201-2.



facilitates the exploitation of new opportunities created by trade policy initiatives. Increased participation by existing and new traders not only builds support for further trade and investment liberalization but also can provide important feedback and can enrich the trade policy agenda.

Hence, trade policy and international business development have now become intermeshed and there are considerable synergies between them. While some commentators have suggested that government expenditures on trade promotion could be better deployed to trade policy, this commentary has attempted to illustrate the legitimate role of government in trade promotion as well as trade policy. Without the assistance of trade promotion measures, the benefits of the liberalization of trade rules and the opening up of new markets would be delayed. Moreover, international opportunities would be available primarily to larger existing exporters. Government sponsored trade promotion activities help spread the benefits of new market access to heretofore domestically focussed companies.

Exposure to the international marketplace also helps companies to adapt to new ideas and technologies. As they experience changes in their economic activities, their perceptions of the world in turn enrich the feedback link to trade policy. As joint ventures, services trade, and technology licensing increase, the private sector will encourage trade negotiators to enter more deeply into new areas, such as labour mobility and intellectual property protection. Trade promotion, together with trade policy will, therefore, continue to be important ingredients in Canada's future prosperity in an increasingly knowledge/experience-based economy powered by new ideas.



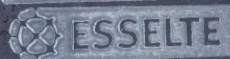




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